

Memorandum

To: Drafting Committee: Oversight of Charitable Assets Act
From: Susan Gary, Reporter
Date: October 18, 2010

In this memorandum I have tried to capture the suggestions, questions, and comments from the Annual Meeting and a few comments I have received directly.

Section 2

2(3) – “covered charity”

Split-interest trusts. The current definition appears to include these trusts. A split-interest trust “holds property dedicated to a charitable purpose” and has a requisite connection with a state. Do we want to include charitable remainder trusts? Charitable lead trusts? (comment from Evelyn Brody)

Religious organizations. Should all religious organizations be excluded? Should houses of worship be excluded? Currently the Act applies to both, except that the requirement to file an annual report (Section 6) does not apply to “a church or other house of worship.” See memo submitted by Boyd J. Black, Associate General Counsel, The Church of Jesus Christ of Latter-day Saints.

Trost (Tennessee) noted that there are three issues with respect to religious organizations: registration (the IRS requires a church with employees to get an employer id number), annual reports (the IRS does not require churches to file 990s), and attorney general oversight (the attorney general may not get involved in issues about who should run a church, but if a church leader uses church money for personal things, then the attorney general will get involved).

Bretz (Connecticut) asked whether attorney general oversight of churches could be limited to “those circumstances where, by virtue of particular activities, the church is engaged in activities which allow the attorney general to be involved.” His example is that in Connecticut the state taxes real property if a church uses it for non-church activities (leases it, for example).

Governmental agencies. Kurtz (Iowa): Should endowment funds held by state universities be subject to the act? Burnett noted that the attorney general represents state universities, so reporting beyond what is already required may not be appropriate, but Kurtz responded that in Iowa the endowments do not currently report to the attorney general. [language in new draft tracks language from UPMIFA]

Exclusion for financial institutions. What does “hold” mean? Willborn (Nebraska).

Holding property. Geu (South Dakota) There are different ways to “hold” property:

- a. (1) Custody and (2) management
- b. (1) Legal and (2) beneficial ownership

Primarily for business purposes. White (Arkansas): should the exclusion specifically exclude trade associations? (501(c)(6)) Do we intend to exclude trade associations? If so, would it be sufficient to explain the exclusion in the Comments?

Conduit. Langrock (Vermont): What if a charity is set up to collect funds and send the funds to another charity? Which state supervises that charity? Assume the charity is in one state and sends funds to a charity in another state. What if the funds are sent overseas?

Temporary basis. What does it mean to hold assets “on more than a temporary basis?”

Business purpose. Trost (Tennessee): Consider an exclusion only for entities organized exclusively for business purposes.

Clark (Pennsylvania) suggested removing the exclusion for entities with a business purpose. His point is that if an entity holds property for charitable purposes, then the attorney general should be able to supervise those assets. One concern is that a few states have authorized “benefit corporations” that are business corporations that are committed to creating a general public benefit. The public benefit is one of the purposes and it could not be described as a “primary” or “secondary” purpose.

Should the coverage of the Act include charities that operate as businesses, even if for nonprofit purposes? Wilborn, Nebraska wrote:

“I’m on the Board of LSAC (the group that runs the LSAT for law schools). It’s a 501(c)(3) owned by the law schools. It seems to be covered by your definitions: (1) its purpose is advance of education, (2) all its property is irrevocably “dedicated to” that purpose – but it receives no donations whatsoever. Moreover, it’s really just a big business (with a very nice market position which has resulted in a large endowment). Despite this, however, the LSAC would not be excluded under §2(3)(B)(ii) because all of its activities are for charitable purposes as defined in the Act.

I have no solutions, but the problem is that there are huge non-profits that fit squarely within your definitions of “charitable purpose” and “covered charity” even though, in reality, they’re simply businesses organized as 501(c)(3).”

Group filing. Myers (North Dakota): A commissioner suggestion that the Act create the possibility for group filing that would cover a charity and all its subsidiary charities.

Political organizations. What are we trying to exclude? (the comments should cover this. Burnett says someone has research on this). Ruth (Nebraska) suggesting leaving it to each state to explain “an organization the primary purpose of which is to influence elections.” Some states have lists of types of organizations.

National parks. Lebrun (South Dakota): We should exclude fundraising organizations

that support national parks.

Benefit of persons in the state. Shetterley (Oregon): What about a scholarship organization? If all scholarships go to students in a particular state, the organization will be a covered charity in that state, but if an organization gives one scholarship in each of 50 states, the organization should not be a covered charity in all 50 states.

Substantial assets. Should the Act explain “substantial”? Should the Act provide a dollar amount, a percentage of total assets, or some other guidance? Should the Act allow the attorney general to exercise regulatory authority to come up with guidelines?

Priority among AGs. If a charity is a covered charity in more than one state, should the Act provide rules about which attorney general takes priority?

Kurtz (Iowa): Consider having home state AG have supervisory control generally and limit other AGs to supervisory role over assets in that AG’s state.

Change definition to say that a covered charity “means a person other than an individual which holds or administers charitable assets and which “

Conducts significant activities. How does this apply to websites that are available electronically throughout the country? The concern is not solicitation, but activities that might be conducted on the website (provision of educational materials). ACTEC comment.

What about radio information in multiple states about activities conducted in one state? For example a biking organization might be organized in Missouri, may sponsor a bike ride in Missouri, and may distribute information about the ride in Illinois. ACTEC comment.

Section 3 – Authority of Attorney General

Following the comments that appear in this section, Burnett pointed out that Section 3 codifies existing common law – the scope of oversight that the attorney general already has. Here are the comments.

Section 3(a)(1)

McKay (DC) (works in the attorney general’s office) says that he would delete (a)(1) because it provides too much discretion to the attorney general. The attorney general should be able to intervene only in the event of fraud or abuse.

Section 3(a). Consider adding to the list as a requirement that the charity have obtained tax-exempt status under state law. (Clark, Pennsylvania)

Trost (Tennessee): Consider adding the words “oversight and protection” to indicate that the attorney general has a broad power to get involved.

Pepe (Pennsylvania): Consider adding something like the business judgment rule to this section. The attorney general should be able to intercede only in the event of abuse and there should be an express grant of broad discretion to the charities.

Langrock (Vermont): The word “designated” may give the attorney general too much power to substitute the attorney general’s idea of what the designated purposes are for that of the charity.

Section 3(b) reads: “(b) The [attorney general] may commence or intervene in an action to enjoin, correct, or obtain damages for a violation of this [act],”

Ferriell (Ohio): The word “correct” is unclear – it might involve an injunction against continued deviation and damages caused by the deviation, but it is not clear what “correct” means and how it might differ from “enjoin” and “obtain damages.”

Section 3(b)(1) and (2)

Kent (Colorado): Suggestion is to add “or a donor’s” to (1) to read “from use for the charity’s or a donor’s designated charitable purposes;”

Gary: (2) covers “a departure . . . from the terms of a charitable trust or a restricted gift.” This subsection should take care of the concern and adding the language to (1) may suggest something more vague.

Hemmeldinger (Rhode Island) commented that Section 3(c) is not clear on whether the attorney general is an interested party in cy pres cases.

Gary: Subsection (c) says that this statute does not limit power under law other than this act. Almost all states have UPMIFA, which provides for cy pres for certain charities. For charities organized as trusts, the common law (or the UTC) gives the attorney general authority. Is that enough?

Wilborn (Kentucky): We need to correlate the phrases: “or any purpose for which the assets were given or committed” with “or any other purpose the achievement of which is beneficial to the community.” Gary: I added “charitable” in Section 3(a)(1).

Grimshaw (Colorado): The section should make clear that the attorney general first decides whether the public interest is at issue and then decides whether to act. The language currently is unclear as to whether the attorney general must follow the public interest.

Section 4 - Investigation

Some comments from the floor suggest that the power of the attorney general should be limited in terms of the ability to request documents. The concerns were not clearly expressed and seemed to be concerns that the attorney general would abuse any power granted to it.

Section 5 – Registration

Trost (Tennessee) Change (b)(2) to read:

“[20] days after a person becomes a covered charity,”

This covers a charity that existed in one state and then moved to another state.

Trost: In addition to the name of the statutory agent, require the name and business address of the ceo or trustee.

Trost: The words “if any” may not be needed with respect to the request for the employer identification number. Make that information (2) (move it up from (5)).

Haynsworth (Minnesota): Do not require the EIN as part of the registration, because that is a public record and people traffic in EINs.

Coggeshall (Maine): An estate with a bequest going to charity should not have to register.

Kent (Colorado): Probate estates may not have to register because they hold property on a temporary basis only. Consider the definition and the registration provision and clarify. It may be sufficient for a probate estate simply to provide notice (and not to register).

Ivey-Soto (New Mexico): Look at the exclusion that allows charity to ask that some information in the registration be kept out of the public record. If the registration is simple and requires limited information, maybe no exclusion is necessary.

[note that this provision may relate to the information in the annual report – check both places]

Mielke (Colorado): The Act should provide the authority for the attorney general to adopt rules and regulations to carry out the powers in the Act. Also, there should be a restriction on the ability to set the fee for registration because otherwise the attorney general will try to fund his or her office with this fee.

Hillyard: Would there be less angst if registration were with Secretary of State rather than the AG?

Section 6 – Annual Reports

When should it be sufficient to file a 990, 990-PF, 990-EZ in lieu of the information listed in Section 6? If the charity’s annual report is being filed on extension, can the charity wait to notify the Attorney General?

Trost (Tennessee): In Section 6(a)(1), put “church or other house of worship” in brackets, rather than take it out. He would like the chance to include it in his state, as part of the Act.

Trost: Consider giving the attorney general the authority to waive a charity’s duty to file

annual reports for five years, based on information in the registration or in the registration plus the first annual report.

Trost: (b)(2)(D) – when the charity lists loans and contracts, the charity should be required to provide information about each loan and contract.

Mielke: (b)(2)(D) – It is important that this cover indirect payments to family members because that is where some of the problems occur.

Line 18 – is entity defined?

Filing deadline – should it be consistent with the IRS filing deadline? (15th day of the fifth month)

Section 6(a)(2)

The subsection exempts a covered charity with low revenue. A better measure for exclusion may be the value of charitable assets held by the covered charity.

Bob Wells (ACTEC, not a commissioner) reports that in New Hampshire which already has a required annual report, the requirement has not created problems for the charities. In his view the annual report serves a useful prophalatic purpose. Also, in response to concerns about the cost to the state of the increased reporting requirements, Wells noted that the small, old fund modification provision of UPMIFA had been used effectively in New Hampshire and had saved money for the charities and the regulator because no court proceeding was necessary for modifications.

Section 7

Section 7(b) – need to limit to amounts above a certain dollar amount.

Sale of substantially all assets – concern about Girl Scout cookies – does “ordinary course of business” take care of the concern?

Section 7(c)(3)(B) says the attorney general can waive requirements of the section. Should the Act provide the standards for waiver or give the attorney general regulatory authority to set the standards?

Hillyard: What is the penalty if a charity does not register under Section 5 or give notice under Section 7?

Clark (Pennsylvania): This Act should coordinate with META (Model Entity Transactions Act). META requires approval of the attorney general if a domestication or conversion involves the diversion of charitable assets. Domestication occurs when an entity changes the jurisdiction under which it is organized or incorporated. Conversion occurs when an entity changes form (e.g., from LLC to corporation).

The language for the provision on merger needs to be changed. In a merger assets do not transfer, rather the entity succeeds to title by operation of law. This is why META talks about the diversion of assets rather than the transfer of assets.

We need to coordinate with META and probably include a legislative note for states that do not adopt both Acts.

Trost (Tennessee): Notice should occur before an action is taken rather than after.

Clarify that if the attorney general waives the notice, the waiver applies only to the specific type of action for which waiver was obtained.

He would take out “other than a creditor” because someone might set up a transfer as a creditor to avoid the notice provisions.

Add something to clarify that if the attorney general does not receive notice then the statute of limitations does not run and the attorney general can take action whenever he or she learns of the problem.

Section 8 – Notice to Attorney General

Should notice be required if the charity and the donor agree to modify a restriction or waive a breach? That is, should notice be required if there is no judicial proceeding?

With respect to notice about a change to a donor-imposed restriction, Willborn (Nebraska) notes that the attorney general will not have received information about restriction, so it seems odd to require the charity to report changes in a restriction. He also wonders about the use of the singular “donor,” and he notes in a foundation supporting a university the “endowment” is modified each time a new donor makes a new restriction. [With respect to this last concern, a new donor restriction typically does not modify a prior restriction. Rather the new restriction is the restriction. We could explain this in the comments.]

McKay (DC): The requirement of notice for disposing of all the assets of a charity overlaps with the ABA’s Model Nonprofit Corporation Act. The Committee may want to bracket this provision so as not to duplicate other law. We should determine what states already have notice provisions.

Clark (California): I am unclear on how registration and notice coordinate. For example, when a revocable trust becomes irrevocable, the trust must provide notice, but does it also then need to register?

New Section 10 (insert between current 9 and 10)

Jurisdiction. The [court] of [] county, or county of domicile of a covered charity shall have jurisdiction over the person of a covered charity and the subject matter of an action or proceeding by the [attorney general].

Enforcement of donor restrictions. Kurtz (Iowa): This act should coordinate with the UTC, which provides for donor standing to enforce a restricted gift. If a charity fails to follow a restriction, does the attorney general or the donor take priority in deciding how the charity should be carrying out the restriction? (Kurtz also mentions UPMIFA, but UPMIFA does not provide for donor standing, except in Iowa.)